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Business and Economic Conditions

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General Business Conditions

THE steel strike reached a critical stage by late October. Heavy inventories at the start enabled steel users to keep going through August and September, but in recent weeks secondary unemployment has been mounting. Nearly 200,000 persons were put out of work during October by steel shortages. By month end, an estimated 865,000 persons (including half a million strikers) were without work because of the steel situation, and many thousands more had been hit by other strikes. Prospects of still greater disruption of production and employment led President Eisenhower on October 19 to request an injunction under the Taft-Hartley Act, calling off the steel strike for 80 days. A federal court issued an injunction on October 21, but its effect has been stayed until November 2 to give the union time to appeal to the Supreme Court.

No matter how soon the strike is halted, the most acute pinch in steel supplies is yet to come. Once a settlement is reached, or an injunction becomes effective, it will take several days for furnaces to be reheated, and several weeks before a balanced flow of finished products is achieved. Steel men fear a shutdown as protracted as this may have caused extensive damage to furnaces and other steelmaking facilities. Unless iron ore shipments on the Great Lakes are resumed soon, some blast furnaces may have to be shut down early next year.

Kaiser Steel has signed a contract with the union at an estimated cost of 22½ cents per hour in wages and fringes spread over two years. The money differences between the union and the other 11 major producers have narrowed, aided by mediation efforts of the President's board of inquiry, headed by Dr. George W. Taylor. The industry has raised its offer to 2.6 per cent of payroll costs – equivalent to the industry's average annual productivity gain. The emphasis in the negotiations has been more in the direction of increased fringes than wages, the men evidently preferring tax-free benefits, though sometimes erroneously construing fringes as without cost to the employer.

A Matter of Principle

The main stumbling block remains the same as before – the issue of local work rules, work schedules, and wildcat strikes. Management's insistence on the right to manage more efficiently has become a deep-set matter of principle, as well as an economic issue. Union proposals for joint committees to study the problem, accepted by Kaiser, have been rejected by the other companies, while employer offers to submit work rule questions to binding arbitration have been rejected by the union.

Dr. Taylor noted in his report to the President that: "The board cannot point to any single issue of any consequence whatsoever upon which the parties are in agreement." Bargaining has continued during the legal struggle over the injunction, spurred by admonitions by the board of

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inquiry, the President, and the court. Both parties are well aware that a settlement arrived at through free collective bargaining without outside pressure is far better for their own interests and those of the nation than one dictated by government. Taft-Hartley offers temporary relief, but does not settle anything. In a way, it may be said that free collective bargaining is on trial.

The President also resorted to a Taft-Hartley injunction in early October to halt the strike of longshoremen on the East and Gulf Coasts. The impact of the steel strike has overshadowed labor unrest in other lines including meatpacking (now settled), glass containers, copper, and zinc (currently out on strike), and aluminum and railroads (negotiations under way).

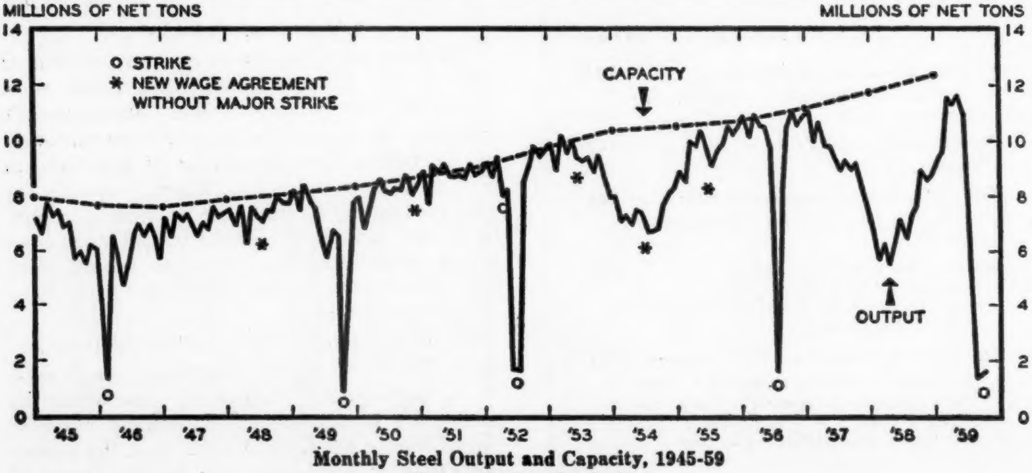
Not surprisingly, the same matter of principle which has been the critical issue in steel negotiations is at the heart of many of these other disputes. Whether negotiators refer to featherbedding, automation, technological progress, or improved materials handling, the basic issue is the same – the insistence of management on its right to introduce more efficient methods and equipment. At a time when American industry is facing a difficult challenge in maintaining exports, business has become more sensitive to union rules which waste manpower. Excessive labor costs can no longer be easily offset by higher prices, and greater efficiency is management's major weapon in maintaining adequate profits to provide for growth.

When all the losses in wages, profits, and disruption of business are added up, this steel strike has probably been the costliest in the nation's history. Payroll losses of strikers alone are figured to exceed a billion dollars. If the industry settlement, like Kaiser's, boosts wage rates 9½ to 12½ cents an hour in the second year of the contract, the steelworker with a wife and one child would need 9 to 11 years of full-time work to make up for the wages he lost during the strike.

Reports received so far from 32 leading steel corporations show a net loss during the third quarter of $108 million, and fourth quarter prospects worsen every day the shutdown continues. Profits have also been reduced in various metal fabricating companies which have had to pay premium prices or incur extra costs to procure steel or have lost business because of material shortages. Federal, state, and local governments are sharing the burden in the form of curtailed tax collections, as well as in increased relief outlays for needy strikers and unemployment insurance payments to those suffering secondary layoffs.

Underlying Economic Strength

It is remarkable how well the economy generally withstood the consequence of labor disturbances of this magnitude through September. Industrial production in September was within 5 per cent of its June record. Over-all metal fabricating activity had dropped only 2 per cent since June, and that was due more to the cutbacks for automobile model changes than to shortages of steel. Despite the heavy layoffs, nonfarm employment was estimated as the highest for any September on record. Personal income receded only 1 per cent from its June record. Retail sales – down 3 per cent from July through September – might have made a better showing had it not been for unseasonably warm weather and the desire of some prospective auto buyers to wait to see the new "compact" models.



Monthly Steel Output and Capacity, 1945-59
(Latest plotting, October)

Construction activity slipped off 5 per cent from its record-high second quarter level, reflecting the pinch of tight money on home building and some slowing in the pace of highway construction.

Gross national product receded less than 1 per cent during the strike-ridden third quarter. Total output of goods and services was estimated at an annual rate of $481 billion, compared with the record $484.5 billion in the second quarter. Consumer spending, business fixed investment, and government outlays continued to rise; the only major declines were in home building and inventory demand. Over-all inventory acumulation was at the annual rate of $10.4 billion in the second quarter, but dropped to only $1 billion in the third, when steel inventories fell and automobile dealers were cleaning out 1959 models.

The economy is in good shape for the upsurge which will inevitably follow the settlement of major labor disputes and the resumption of full-scale steel production. Inventories of steel, automobiles, and many other types of goods will need to be rebuilt. The return to work of strikers and others who were laid off will boost payrolls and purchasing power, while other consumers who held back for fear that spreading layoffs might affect them will be in a mood to spend more freely. Relieved of uncertainties and stimulated by expanding sales, many businessmen may make more optimistic reappraisals of their capital expenditure programs.

It is expected that most of the business postponed because of the strike will be pushed forward into early 1960. Because of steel shortages, for example, passenger car output may fall 300,000 or 400,000 short of original fourth-quarter schedules, tending to keep assembly lines busy early in 1960. General expectations are that the initial upsurge in business activity — based largely on the temporary stimulus of recovery from the strike — will give way to a high-level plateau, or more gradual advance, for the rest of 1960.

An Unemployment Problem

The direct and indirect effects of strikes kept more than one million persons off their jobs during October. This involves a large wastage of skilled manpower as well as hardships and deprivations for the people affected. Most of this unemployment will never be reflected in the official unemployment statistics. One of the curiosities of the labor force figures is that strikers (unless seeking other work) are classified as employed even though most of them are idle and some of them become entitled to unemployment benefits.

There is proof of the financial resources of the workman, as well as of the generous provisions for public assistance, in the fact that so many can make do without gainful employment for so long. Nevertheless, the loss to him and to the nation is very real. The idle moment can never be recaptured and put to work.

Trade unions often have been in the forefront demanding government actions to reduce unemployment. It was ironic that the steel union, opposing government action to get men back to work and check spreading unemployment, argued that the economic effect of the steel strike was so slight that it did not imperil the national health or safety. A strike intended, according to the union's advertisements, to add a billion dollars to payrolls has already subtracted more than that.

It is worthwhile recalling the assertion, at the AFL-CIO convention in Puerto Rico last February, that Congressional approval of President Eisenhower's program for balancing the federal budget would condemn the United States to a permanent pool of five or six million jobless workers and would bring about national "economic collapse." Then, as well as later in the "march of the unemployed on Washington" rally in early April, the AFL-CIO urged federal intervention to relieve unemployment, namely by easy money and increased government outlays for housing, education, and all sorts of public works. Yet none of these things would have dealt with the present unemployment due to strikes.

The Hat Trick

At the time of the Puerto Rico convention, the official unemployment figure, swollen as usual by the effect of cold winter weather on construction and agricultural work, was reported at 4.7 million. Secretary of Labor James P. Mitchell, recognizing the strong recovery under way in business and job opportunities, predicted that by October the unemployment figure would drop to three million, getting down toward a practical minimum in an unregimented peacetime economy. Accused by union officials of "talking through his hat," the Secretary reportedly offered to eat the hat he was accused of talking through if he did not prove right.

The October unemployment figure, due for publication in mid-November, may exceed three million. But every unbiased observer will agree that unemployment could have been below three million if the strike had not arrested steel production. By mid-October, about 280,000 persons in related industries had been laid off because of the steel strike and were counted among the unemployed. Indeed, as far back as April

the AFL-CIO's *Economic Trends and Outlook* conceded that the Secretary's "prediction will probably prove to be correct, on the basis of present trends." Since he was not talking through any hat, there is none to eat.

A special Senate Committee, appointed as an outgrowth of trade union complaints over lack of job opportunities, is now studying "the problem of unemployment." It is to be hoped that the Committee will note that unemployment has many reasons and facets. It is an expression not only of immobilities, such as those that keep people from leaving depressed areas, but also of treasured freedoms, such as those of people to work part time or intermittently if they prefer, to quit in search of something better, and to strike. Today the right to strike is pitting its strength against another valued right – the right of the citizen to protection from continuous wage and price inflation.

Third Quarter Corporate Earnings

Corporate reports covering the third quarter show little change in aggregate earnings over the levels of last year, compared with sizable gains in the first two quarters. The less favorable year-to-year comparison was caused in part by the rising trend during 1958, in part by strikes. Reports now available from 785 nonfinancial companies give a combined net income after taxes of approximately $2.6 billion, a drop of 29 per cent from the preceding quarter but practically the same as in the third quarter of 1958. The number of companies with decreases from the preceding quarter exceeded those with increases by 3-to-2. As compared with a year ago the increases outnumbered the decreases 3-to-1.

For the first nine months, net income of $9.3 billion increased over last year by 36 per cent. This was lower than the 56 per cent rise in our previous tabulation for the first half year. A considerable number of companies announced nine months' earnings at new high records as a result of the growth in dollar volume of sales, combined with reductions in operating costs achieved by continuing capital outlays for plant modernization. A summary of the changes by major industry groups is given in the accompanying table.

Trends in Manufacturing

Reports available from 598 manufacturing corporations show third quarter net income 32 per cent below the second quarter, but 5 per cent above the third quarter of 1958. For the first nine months, the manufacturing total was up 43 per cent, with increases outnumbering the decreases 9-to-1.

Major industry groups reporting above-average gains for the nine months – often representing recovery from depressed earnings or deficits last year – include textiles, tires, chemicals, building materials, and automobiles. Other groups realizing smaller but still substantial gains were paper, drugs, electrical equipment, and machinery.

NET INCOME OF LEADING CORPORATIONS FOR THE THIRD QUARTER AND FIRST NINE MONTHS

(In Thousands of Dollars)

No. of Cos.	Industry Groups	Reported Net Income Third Qr. 1958	Second Qr. 1959	Third Qr. 1959	% Change from Third Qr. 1958†	Second Qr. 1959†	Reported Net Income Nine Months 1958	1959	Per Cent Change†
39	Food products and beverages	$ 74,810	$ 80,720	$ 81,725	+ 9	+ 1	$ 217,133	$ 236,191	+ 9
10	Tobacco products	60,260	63,042	67,754	+12	+ 7	163,351	183,318	+12
28	Textiles and apparel	16,802	29,308	29,018	+73	– 1	34,910	82,943	+—
8	Tires, rubber products	18,355	28,005	24,032	+31	–14	46,981	80,093	+70
34	Paper and allied products	45,998	60,285	55,836	+21	– 7	127,836	165,202	+29
37	Chemical products	157,280	265,505	219,830	+40	–17	427,644	693,866	+62
31	Drugs, soap, cosmetics	97,924	87,714	118,416	+21	+35	257,217	296,624	+15
29	Petroleum prod. and refining	578,847	525,603	579,142	+—	+10	1,482,404	1,690,416	+14
52	Cement, glass, and stone	117,464	148,185	134,549	+15	– 9	256,947	369,726	+44
32	Iron and steel	179,566	446,258	–108,366	–—	–—	480,413	644,871	+34
36	Electrical equip., radio & tv	110,021	125,308	140,771	+28	+12	285,760	378,036	+32
47	Machinery	85,460	101,898	98,473	+15	– 3	212,265	267,965	+26
109	Other metal products	151,489	197,645	168,705	+11	–15	368,925	511,705	+39
31	Automobiles and parts	35,981	552,288	194,141	+—	–65	384,692	1,241,936	+—
19	Other transportation equip.	24,292	18,974	7,609	–69	–60	79,553	44,787	–44
56	Misc. manufacturing	95,489	115,975	128,907	+35	+11	222,668	331,922	+49
598	Total manufacturing	1,850,038	2,846,708	1,940,542	+ 5	–32	5,048,699	7,219,601	+43
23	Mining and quarrying	24,411	33,658	20,659	–15	–39	71,589	85,837	+20
35	Trade (retail and wholesale)	48,689	56,577	51,576	+ 6	– 9	140,185	160,126	+14
17	Service and amusement	10,916	13,107	11,509	+ 5	–12	29,097	36,462	+25
54	Railroads	215,316	192,030	93,059	–57	–52	342,398	388,476	+13
56	Electric, power, gas, etc.	156,048	167,914	167,794	+ 8	–—	525,099	569,978	+ 9
2	Telephone and telegraph	252,704	286,037	283,769	+12	– 1	695,982	830,726	+19
785	Total	$2,558,122	$3,596,081	$2,568,908	+—	–29	$6,853,049	$9,291,206	+36

†Increases or decreases of under 1% or over 100% not shown. — Deficit.

This widespread improvement in earnings will benefit the United States Treasury by proportionate increases in corporate income tax revenues. A conspicuous development on the other side of the government ledger, however, was the steel strike, which brought about a collapse in third quarter earnings and net deficits for several leading producers. Nevertheless, the strike-anticipating boom during the first half year helped keep earnings for the nine months well above the same period of '58.

Quarterly tax details given by 9 steel companies with deficits show a swing from a tax liability in the 1958 third quarter of $128 million to a net credit against accrued taxes in the third quarter this year of $178 million.

Total dollar sales by reporting companies in all branches of manufacturing for the first nine months were 17 per cent over a year ago, while the average net profit margin per sales dollar widened from 5.3 to 6.7 cents. There were notable exceptions among individual companies, however, particularly where activity was cut back in the third quarter.

Earnings and Dividends

In lines other than manufacturing, earnings of reporting companies have continued generally to run ahead for electric, gas, and telephone utilities as well as trade, and business services. Railroads were mixed.

Corporate dividend payments have tended to hold much more stable than earnings, both on the upside and downside of the business cycle. According to Commerce Department computations, dividend payments for the first nine months this year by all U.S. corporations exceeded those of 1958 by 4 per cent.

The long-term upward trend in total dividend payments brought a total for the full year 1957 of $12.5 billion, which represented a 56 per cent payout of the net income placed at $22.2 billion. In 1958 the dividend total dipped only to $12.4 billion, while net income declined to $18.9 billion, raising the payout ratio to 66 per cent — the highest since 1939. Over the 20 years the lowest payout was 35 per cent, in 1948. The 20-year average payout was just 50 per cent — meaning that only one half of corporate earnings was passed along to shareholders, while the other half was retained for financing capital replacement and growth. In the depression period 1930-38 the payout exceeded earnings. For the active years 1922-29 the average was 66 per cent.

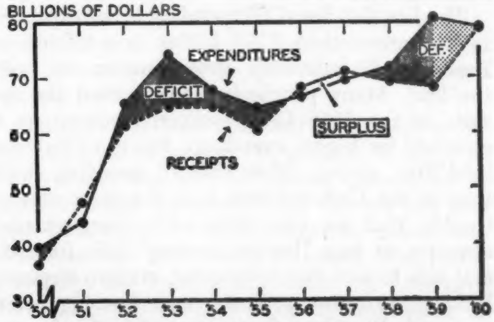
Holding the Budget in Balance

The Budget Bureau's September review revealed that President Eisenhower's goal of a balanced federal budget for the fiscal year ended June 30, 1960, is being reached. If official expectations are borne out, the federal budget will have moved within a single year from a deficit of $12.5 billion in fiscal '59 to a balance. This is no small achievement. There were many doubting Thomases last December when the President announced his intention of proposing a balanced budget for the new fiscal year. It just did not seem possible against the background of four years of constantly rising federal expenditures and political pressures for still more.

On the expenditure side, the battle of the budget centered on resisting continuing increase rather than positive curtailment. The new estimate of fiscal '60 expenditures is but $1.8 billion below the $80.7 billion figure for fiscal '59, and this decline is entirely accounted for by absence of certain nonrecurring outlays included in the fiscal '59 year. Apart from some anti-recession programs which have lapsed, the main special item in last year's budget was the $1.4 billion additional subscription to the International Monetary Fund (IMF).

As the chart indicates, the rebalancing of the budget hangs on revenue gains growing out of the rapid recovery in business activity, taxable income and profits. Fiscal '60 receipts are expected to rise $10.8 billion above '59 to an unprecedented $79 billion. The Treasury figures personal income to rise to a new high of $382 billion in 1959, $23 billion more than was recorded in 1958. Corporate profits before taxes are projected at $48.5 billion in 1959, $11.4 billion more than corporations earned in 1958 and 8 per cent beyond the old peak of $44.9 billion attained four years ago.

The projections were made in mid-September and assumed prompt settlement of the steel strike. The extension of the strike through October has imperiled the revenue expectations and the narrow budget balance. How much of the lost revenues are recovered in fiscal 1960



U.S. Government Budget Receipts, Expenditures, and Surplus or Deficit, Fiscal Years 1950-60

will depend on how soon major labor disputes are settled and how fast the economy surges forward to new peaks.

The recovery in business proved more rapid than had been anticipated back in January when the President, in his budget message, first revealed plans and expectations for fiscal '60. As the table below shows, the receipts estimate has been raised $1.9 billion, as is also true of the expenditure projection. Although the President gained widespread public support for balancing the budget, the natural tendency seems to be for outlays to run a race with prospective revenues.

Congress took no action on the President's proposals to raise postal rates and increase budget revenues $150 million by raising the aviation gasoline tax, levying a new tax on jet fuels, and tightening up on tax treatment of cooperatives. Moreover, Congress met only in part the request for a higher gasoline tax to replenish the Highway Trust Fund, outside the budget; it raised the tax from 3 to 4 cents a gallon rather than to 4½ cents as requested. A victim of cost inflation, the highway program is having to be slowed.

Federal Budget Expenditures and Receipts

(In Billions of Dollars)

	Fiscal '57 Actual	Fiscal '58 Actual	Fiscal '59 Actual	Fiscal '60 Jan. Est.	Fiscal '60 Sept. Est.
Expenditures	$69.4	$71.9	$80.7	$77.0	$78.9
Receipts	71.0	69.1	68.2	77.1	79.0
Surp. or Def.	+1.6	—2.8	—12.5	+0.1	+0.1

Struggle to Level Out Expenditures

At $78.9 billion, federal spending in fiscal '60 will be higher than in any other peacetime year save only fiscal '59 when the nonrecurring outlays swelled the total. The failure of record revenues to leave a sizable surplus for debt and tax reductions demonstrates the tendency of legislators to spend every penny of available revenues. Yet a stable economy requires surpluses for debt retirement in prosperous times. And a dynamically growing economy will require income tax rate reforms.

The fact that fiscal '60 spending is not expected to be greater than $78.9 billion is a tribute to President Eisenhower's determination to hold the line. Many people had interpreted the results of the 1958 Congressional elections as a mandate for bigger spending. But the President held firm, saying, "that kind of spending must stop or the United States is in the most serious trouble that we can think of." Congressional attempts to pass "budget-busting" bills for federal aids to area redevelopment, civilian airports, local government projects, and housing were met with Presidential vetoes or threats of veto. The public, fearful of inflation and concerned by the gold outflow, supported the President, making Congress more willing to listen to counsels of moderation from its leaders. Nevertheless, as the table below shows, almost every major nondefense spending category was increased above the President's January recommendations.

Contrary to common belief, it is not increased defense spending which is pushing the budget up. Cutbacks in outlays for older, conventional weapons, and concentration on only the most promising of the new weapons, have made room for more spending on missiles within an unchanged, or even reduced, over-all National Security program. As the table indicates, National Security outlays in fiscal '60 are figured at $45.7 billion, down $698 million from '59 and $4.7 billion below the '53 Korean War peak. Outlays for International Affairs and Finance, which include economic aid to allies and other nations, are expected to drop back to $2.1 billion in '60 after being pushed up in '59 by the $1.4 billion additional subscription to the IMF.

Federal Budget Expenditures by Major Programs
Fiscal Year 1960

(In Millions of Dollars)

	Fiscal '60 Current Est.	Change From Fiscal '60 Jan. Est.	Change From Fiscal '59 Actual
Commerce & Housing	$ 2,925	+ 682	— 498
Agriculture & Agricultural Resources	6,052	+ 56	— 510
Natural Resources	1,792	+ 82	+ 122
Labor & Welfare	4,407	+ 278	— 15
Veterans' Services & Benefits	5,133	+ 45	— 42
General Government	1,678	— 57	+ 78
Interest	9,079	+ 983	+1,398
Allowance for Contingencies	75	— 25	+ 75
Nondefense	31,141	+2,045	+ 603
Major National Security	45,713	— 92	— 698
Internat'l. Affairs & Finance	2,051	— 78	—1,699
Total	$78,905	+1,875	—1,794

Thus, the crux of the federal spending problem remains the rising drift in nondefense outlays, which has been aggravated by increased interest costs on the enlarged debt. Compared to actual fiscal '59 outlays, projected nondefense spending (including interest) in fiscal '60 will be up $603 million to $31.1 billion. This is $12 billion, or 63 per cent, more than was spent on nondefense programs as recently as 1954. The rise would be greater but for declines in a number of programs which were swollen in '59 by anti-recession spending.

Expenditures for Commerce and Housing, for example, are expected to show a $498 million decrease from fiscal '59 to $2.9 billion, but this merely reflects the end of the Federal National Mortgage Association's $1 billion anti-recession program of mortgage purchases to stimulate

home construction. The effect of Congressional actions was to boost spending $682 million above what the President had proposed in January. The refusal to raise postal rates as requested is mainly responsible for a $495 million increase in the expected post office deficit. Budget outlays for Commerce and Housing would be even larger if the President had not vetoed housing bills twice and insisted on less extravagant aid to airports and area redevelopment.

Expenditures for Labor and Welfare, now figured at $4.4 billion in fiscal '60, have been increased $278 million above the President's January estimate and now are only $15 million below fiscal '59 when the total was swollen by anti-recession spending. If the President had not insisted on terminating the emergency federal program of temporary unemployment compensation put into force during the 1958 recession, Labor and Welfare spending might be at a new high around $5 billion in '60.

Intractable Farm Problem

Outlays for Agriculture are now figured at $6.1 billion in fiscal 1960, more than double their 1954 level. The $510 million reduction from actual spending in '59 reflects the termination of the acreage reserve part of the soil bank program. Congress made practically no further progress toward reform of the price support system which, in Budget Director Maurice Stans' words, "continues — at the cost of the taxpayer — to create incentives for farmers to produce more than we can consume or sell. While we struggle for new formulas, farm technology outpaces Congressional efforts to deal with it. A year from now, we will have more than $10 billion worth of farm commodities on hand. We will be spending at the rate of $1.5 billion a year just to carry and manage this inventory."

While outlays on Veterans Services and Benefits will be little changed at $5.1 billion in fiscal '60, considerable increases lie ahead because of Congressional action this past session widening access to pensions for widows of veterans who served in the Korean War and World War II. With this provision, the bill Congress passed may add about $9 billion to budget costs over the next 40 years. Outlays for General Government are up $78 million to $1.7 billion in fiscal 1960, mainly reflecting construction of new federal office buildings.

Spending on Natural Resources is figured to rise only moderately in fiscal '60 to $1.8 billion. However, considerably higher spending levels in future years are assured by Congressional success in authorizing starts on 67 new river, harbor and reclamation projects over Presidential objections. The President calculated that before they are completed these projects will cost at least an additional $800 million. He expressed "disappointment that the majority in Congress seems to find it so difficult to wean itself from the pork barrel."

An appealing case can be made for almost any federal spending program. But it is time we realized that, rich as we are, we cannot afford everything. As Budget Director Stans points out:

> . . . I think we ought to face up to the fact that, if we ever accept the principle that the sum of all demands against the Treasury — by Government agencies or by the people across the country — constitutes a requirement that we must meet, then we will go broke just as surely as you would go broke, personally, if you tried to meet all the desires of the members of your family.

Connecticut's Governor Abraham Ribicoff has the right answer: "We must have the guts to say 'No.' There is no big bag of money; it always comes from the people."

The Rising Interest Burden

One federal expenditure about which Congress has expressed concern is the mounting cost of interest on the public debt. As the table shows, interest on the debt is now figured to hit a new high of $9.1 billion in fiscal '60. This is a great deal of money, more than was spent on the entire federal budget as recently as 1940. But big debts naturally involve large interest burdens and the U.S. public debt today is an unprecedented $291 billion. Even at $9.1 billion our interest cost averages little more than 3⅛ per cent. We would have a smaller interest burden today if we had not been so indulgent of deficits in the past.

Moreover, as Treasury Secretary Anderson has pointed out, the $12.5 billion federal deficit incurred in fiscal '59 has been one of the main factors pushing up interest rates. Coming at a time when economic recovery was piling increased business credit demands on top of record mortgage borrowing, it overstrained the credit market. In this period the Treasury should be running a surplus and paying off some of its debt, thus releasing funds for private borrowers and sparing itself interest costs.

Congress has been reluctant to face up to the realities of the situation. It has tried to keep the Federal Government's borrowing costs down by legislative fiat, refusing to lift the 4¼ per cent legal limit on rates the Treasury may pay on new securities due in 5 years or more. The result, ironically, has been to aggravate the Treasury's borrowing problems. Forced to borrow in an already congested short-term market, the Treas-

ury paid 5 per cent in October to sell 4-year 10-month notes, the highest rate on any Treasury security since 1929. Treasury officials noted that they could have obtained longer-term money for less than 5 per cent but were barred from doing so by the prohibition against paying more than 4¼ per cent.

It is worth noting that if the entire public debt were at short term, say in Treasury bills, and had to be refinanced today at prevailing market rates of 4 to 5 per cent, the interest burden would be around $12 billion. It seems almost incredible now that the Treasury was criticized for extravagance in paying 3¼ per cent to sell 30-year bonds in 1953. The Treasury would be having an easier and cheaper time of it if more debt funding had been done then.

President Eisenhower has stated simply: "Now when you are getting to this kind of cost, just for interest, it would look to be the part of wisdom to start getting the debt down a little bit. . . ."

The Common Task

Holding down government spending to develop surpluses for debt retirement and eventual easing of tax burdens will not be easy. Too many people believe that more and larger federal spending programs are synonymous with progress. Each new program is presented as the final answer to a pressing problem. In Adlai Stevenson's words: "We Americans have a penchant for believing that sufficient inputs of energy and dollars can solve any problem."

Moreover, by the time it becomes clear that we are not getting our money's worth, vested interests have been built up which resist cut-backs. Congressman Charles E. Bennett of Florida offered a colorful commentary in the July 1959 issue of *Nation's Business:*

> To end a going federal program is almost unthinkable, even though it may have become obsolete or undesirable. I can recall only two federal programs that have been abolished since I was first elected to Congress: Uncle Sam no longer stables stallions for breeding cavalry horses, and is now out of the rum-distilling business in the Virgin Islands.

Nevertheless, there is encouragement in the way the American people revolted against big spending proposals in the Congressional session just ended. President Eisenhower described it as "an historic turnabout":

> By letters, telegrams, telephone calls and personal visits to their Congressmen, the folks back home demanded a halt to excesses being advanced in Congress. Before the session had been under way two months, the public had forced the majority to shelve at least temporarily its more lavish proposals.

The President has given assurance that he will continue to press economy when Congress reconvenes in January: "Should we again see extravagant proposals sponsored in the Congress, I shall continue to oppose them. I am confident of the continuing energetic support of the American people if such a struggle should develop."

The objectives of a prospering solvent America are so important that we should be able to get bipartisan agreement upon the necessity for surplus revenues in periods of prosperity to permit debt retirement and tax reform. The needs of tomorrow are for fiscal policies which restrain inflation while stimulating people to harder effort and capital accumulation to put tools in the hands of our children.

Julian Baird, Under Secretary of the Treasury, has aptly summarized the challenge:

> We are entering what is being widely forecast as the most prosperous period of our entire history. Within the next 25 years, we can virtually double the producing capacity of America. We will be creating some 35 to 40 million new jobs to take care of our expanding population. We will have to develop an energy base to meet a demand which may well treble. We and other advanced nations will be sharing know-how and offering a helping hand to the 700 million people in 22 countries who have won political independence in the past 16 years.
>
> These are dazzling opportunities. Barring a serious worsening in the international situation, I believe these goals are attainable — but *only* if we have the informed public opinion, the will, and the courage to maintain sound financial policies which are essential to healthy and sustainable growth.

The "New Situation" in World Finance

A month ago, finance ministers and central bankers from 68 member countries gathered for the 14th annual meetings of the International Monetary Fund and the International Bank for Reconstruction and Development. The most striking impression from the meetings, held this year in Washington, was that United States economic and financial relations with the industrial countries of Western Europe and Japan have reached a turning point. These nations are now strong and enjoying a bright new era of prosperity. For them, dollar shortage that the United States had to alleviate through the Marshall Plan and other programs has turned into a dollar surplus.

Western Europe also has payments surpluses with many Latin American and other less developed countries. In the present pattern of international payments, the focal point of concern is the position of the underdeveloped nations whose capacity to earn foreign exchange and move ahead has been weakened by relatively low prices of most primary products.

These shifts in balances of payments, together with remarkable gains in output and productivity, the restoration of financial stability, and greater freedom of trade and payments in Western Europe and Japan, have created, in the words of the Fund's Managing Director, Dr. Per Jacobsson, "a new situation" in the world economy — one that calls for "a fresh examination" of international financial problems.

Enlargement of Fund Resources

This "new situation" is clearly visible in the Fund's own business. Drawings on the Fund have greatly declined, and past borrowings have been repaid in record amounts. Recent drawings have been made mainly by primary-producing countries, which have sought not only U.S. dollars, but also sterling and other European currencies.

IMF Transactions, Gold and U.S. Dollar Holdings

(In Millions of Dollars)

Year Ended Dec. 31	Currencies Drawn U.S. Dollars	Currencies Drawn Other	U.S. Dollars Repaid	U.S. Dollar Holdings	Gold Holdings
1947	$ 462	$ 6	$ 6	$1,598	$1,356
1948	197	11	11	1,391	1,436
1949	102	—	2	1,289	1,451
1950	—	—	24	1,305	1,495
1951	7	28	74	1,324	1,530
1952	85	—	102	1,288	1,692
1953	68	162	321	1,383	1,701
1954	62	—	210	1,565	1,737
1955	28	—	232	1,706	1,808
1956	678	15	113	1,142	1,892
1957	977	—	64	775	1,380
1958	252	86	369	792	1,532
1959*	96	25	307	971	1,585
Total	$3,011	$333	$1,835		

*Eight months ended August 31. Source: International Monetary Fund.

At the end of August 1959, the Fund held $2.6 billion in gold and U.S. dollars. Of this amount, $1.1 billion was committed under so-called stand-by arrangements, which enable the beneficiary to draw on the Fund up to a given amount during a specified period.

The Fund, therefore, already had sizable holdings of gold and U.S. dollars when, on September 16, 1959, the additional subscriptions, proposed at the New Delhi meetings in October 1958 and approved earlier this year, became effective. As a result, the Fund's gold and U.S. dollar holdings, after all the subscriptions have been fully paid, will increase by almost $2.3 billion. Of this amount, the United States has contributed $1,375 million, of which 25 per cent, or $344 million, has been paid in gold, and the balance in non-interest bearing U.S. Treasury demand notes; the latter can be cashed if the Fund needs more dollars. The 25 per cent gold contributions of other nations will total almost $1 billion.

For most countries, including the United States, the increase in the subscriptions was 50 per cent. In recognition of their growing importance in world trade, the subscriptions of Canada, Germany, and Japan were increased by more than 50 per cent. These increases, together with the 50 per cent boosts in the subscriptions of the United Kingdom, Belgium, France, and the Netherlands, greatly enlarge the Fund's holdings of currencies other than the U.S. dollar that are likely to be most in demand.

The purpose of providing the Fund with more resources, according to the Fund's Managing Director, has been "to give members confidence that in the Fund they have an effective second line of reserves — particularly in cases of emergency when, in a relatively short period, there may be substantial calls upon the Fund." In the view of the Fund's management, enlarging quotas will not bring about any change in the policies governing the Fund's resources that have successfully stood the test of practical application.

World Bank's Capital Increase

In contrast with the operations of the Fund, which reflect balance-of-payment swings of member countries, the International Bank for Reconstruction and Development has continued to maintain the high rate of lending reached in 1958 — somewhat over $700 million during the fiscal year ended June 1959. Of this amount, about one third was to India and Japan and the bulk of the remainder to developing nations in Asia, Latin America, and Africa. The Bank's lending is running 75 per cent above the average rate of $400 million a year during 1954-57.

Unlike the Fund, the World Bank is designed to rely mostly on borrowings in the market to secure funds for lending. New bond issues by the Bank reached the equivalent of $432 million during the year ended June 1959; in August, a further issue of $100 million was floated. By far the largest part of the bonds is being placed outside the United States. Last year, for the first time, the Bank made public offerings of bonds denominated in German marks and Belgian francs. The German issue was the largest public offering of non-dollar bonds made thus far by the Bank; Germany was, in fact, the largest single source of borrowed funds. Today, about half of the Bank's funded debt is held outside the United States, though mainly in dollar bonds.

Like the Fund, the Bank has been enlarged. Most member countries have doubled their subscriptions to the Bank's capital. Over and above this, 17 countries, including Canada, Germany, and Japan, have made additional increases. Of these special additional subscriptions, a small portion is being paid in cash. The great bulk of the Bank's capital is unpaid, but subject to call

if needed to enable the Bank to fulfill its obligations. This greatly strengthens the Bank's ability to borrow. The uncalled subscription of the United States, which is a particularly important element in the marketability of the Bank's bonds, has been increased from $2,540 million to $5,715 million. The Bank's total funded debt as of June 30, 1959 stood at the equivalent of $1,905 million.

The Dollar and Western Europe

The growing usefulness of Western European currencies is a most encouraging development to the World Fund and Bank. It is also gratifying that so many major countries were able to achieve external convertibility without any new calls on the Fund. Strengthening Western Europe – economically as well as financially – has been a primary objective of the United States since World War II, in line with its policy of rebuilding free multilateral trade and payments throughout the Free World.

Over the past two years, however, the build-up in Western Europe's reserves has involved increased disequilibrium in the U.S. balance of payments. No country, however rich, can afford indefinitely the deficit the United States is running at the present time – around $4 billion this year* on top of last year's deficit of $3.4 billion; during the eight years ended 1957, the deficit averaged $1.3 billion†. As Secretary of the Treasury Robert B. Anderson stated in addressing his fellow governors of the Fund:

> It is our hope that this large payments difference will be reduced by increases in our commercial exports of goods and services relative to our imports of them. But, while we will put emphasis on strengthening our capacity to export, we cannot be unmindful of other factors and therefore we will also keep our whole international financial position under review.

Foreign officials at the Washington meetings were impressed by the restraints being applied to inflationary tendencies in the buoyant American atmosphere: the apparently successful efforts to rebalance the federal budget after the disturbing $12½ billion deficit in the year ended June 1959; the restrictive credit policy being pursued by the Federal Reserve System; the emphasis of the Administration on improving the structure of the public debt; and, last but not least, the resistance of industry to the process of wage inflation. "It is . . . with keen satisfaction," said President Blessing of the German central bank, "that we have witnessed the vigorous endeavors to maintain stability that are being made in the United States."

Dr. Blessing stressed that maintenance of monetary stability in the United States is "of tremendous importance" for other nations because the dollar is "the leading currency of the world and one of the main pillars of our international currency system."

A sound dollar, therefore, is not only a matter of national interest to us, but is also fundamental to maintaining the economic and financial strength of the entire Free World. For if the United States were to weaken its position as the chief banker of the non-communist world, the whole international order could be upset.

Many of the finance ministers and central bank governors who attended the meetings also recognized that a more nearly sustainable balance in international payments could not be restored by American policies alone. Some of the adjustments will have to come from other countries.

The Ending of Discriminatory Restrictions

Despite the progress made over recent years in relaxing direct restrictions on foreign trade and payments, discriminations against the United States and other dollar countries are still substantial. They variously apply not only to commodity trade but also to payments for services and capital transactions.

Countries with replenished, if not overflowing, exchange reserves can no longer point to "dollar shortage" as justification for discriminating against dollar goods. In the personal view of Dr. Jacobsson, discriminatory restrictions remaining from the days when Europe was short of dollars "are now more clearly seen to be protectionist devices."

A week ago, the Fund's executive directors declared that "there is no longer any balance of payments justification for discrimination by members whose current receipts are largely in externally convertible currencies." While recognizing that "a reasonable amount of time" may be needed to eliminate discriminatory restrictions entirely, they exhorted members to proceed "with all feasible speed." A few days later, at the GATT conference in Tokyo, representatives of leading nations agreed that countries with enough dollars should lift restrictions on dollar goods.

Now that the U.S. balance of payments has, for two years, shown a bulging deficit, American opinion is becoming more and more sensitive to obstacles raised against American goods by

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*Excluding the $1,375 million subscription to the International Monetary Fund.

†For a discussion of recent U.S. balance of payments trends, see the articles on "Dwindling Export Surplus" and "U.S. Competitive Position in World Trade" in the July 1959 and March 1959 issues of this *Letter*.

countries whose own exports to the United States have risen sharply. Not only are there still long lists of goods subject to quota restrictions but customs duties are frequently much higher abroad than here. For instance, American cars are subject in Western Europe to duties averaging 25-30 per cent while foreign cars pay only 8½ per cent U.S. duty.

It is unlikely that ending discrimination against dollar goods would lead to increases in imports large enough to endanger the balance of payments of the liberalizing countries. Fears of this kind are not borne out by the experience of those European countries that have advanced farthest in eliminating direct obstacles to trade.

Free multilateral trading lets the price mechanism operate through as wide an area as possible, bringing gains to all participating nations. It leads to more productive use of economic resources and, hence, to higher living standards than would otherwise be possible.

The IDA

The topic most prominently discussed at the Bank meeting was the United States proposal to create an International Development Association (IDA) as an adjunct of the World Bank.

The new body would grant loans at low interest rates, repayable in whole or in part in the borrower's own currency. On this is grafted the idea that local currencies accruing out of repayments might in turn be lent either to domestic borrowers or to other countries that could use them for financing imports. It is thought also that the large amounts of local currencies generated under United States aid and loan arrangements, including the sale of surplus farm commodities, could similarly be used by IDA.

According to the U.S. proposal, the capital of $1 billion would be provided by member countries in amounts proportionate to their subscriptions to World Bank capital; the United States' share would be $320 million. Members would pay in 50 per cent of their subscriptions initially, and the remainder in equal instalments over five years. At 5-year intervals, IDA would consider the desirability of increasing its capital. The United Kingdom and other countries concurred with the U.S. proposal that the subscriptions of industralized countries should be convertible.

But the debate at the Washington meetings revealed distinct reservations about some aspects of the proposal. Doubts were expressed as to the usefulness of endowing the new institution with so-called special resources in local currencies, as envisaged by the United States. Such local currencies would be transferred to IDA over and above the subscriptions to initial capital.

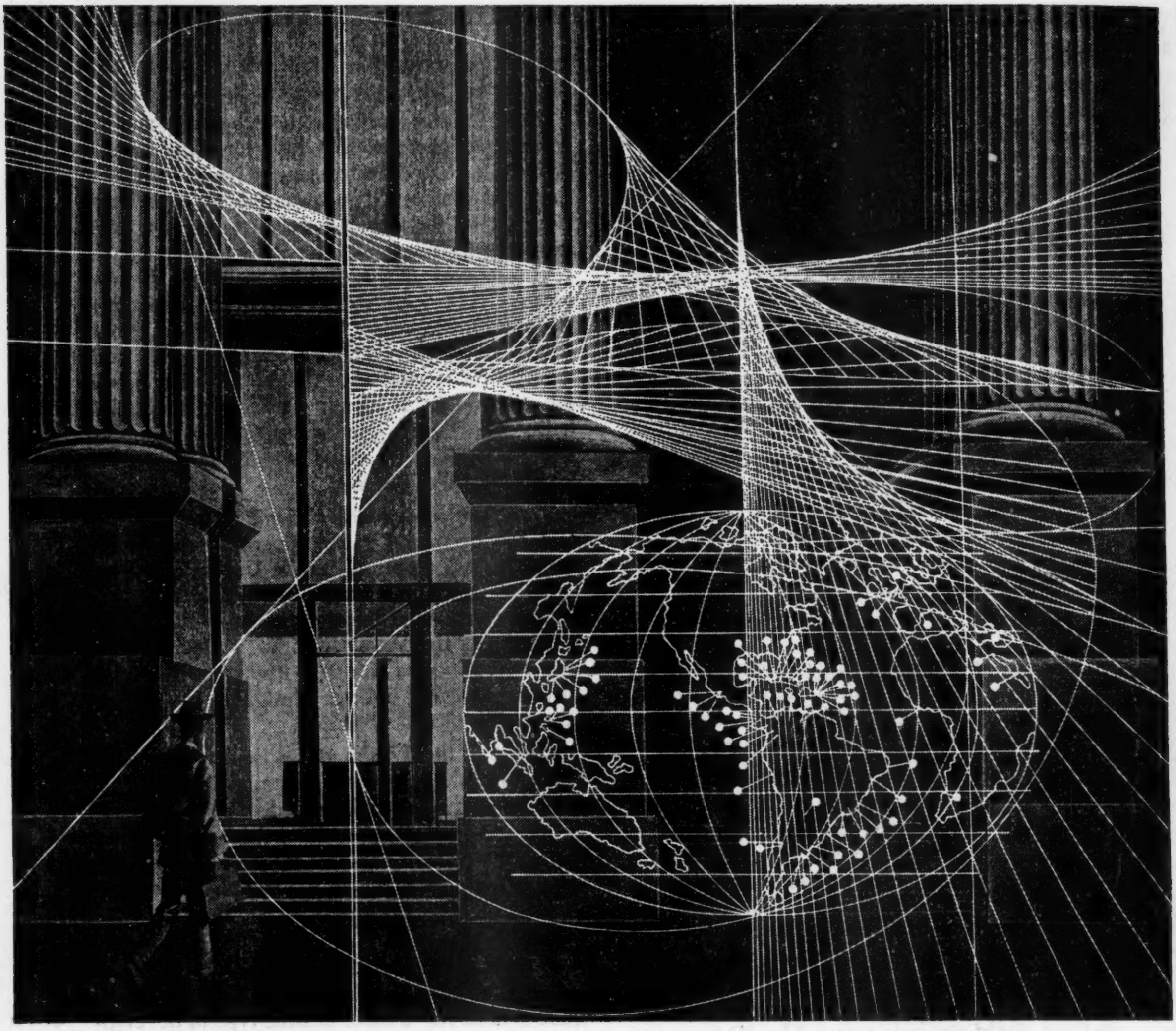
The idea that local currencies, whether accrued from repayments of IDA loans or transferred to it by the United States, might be thrown in to help make the world go around raises many questions. It is, for instance, hard to see how local currency balances may be used to increase the real resources of the country in which they are located. If they are lent locally to finance domestic investment outlays, they give rise to additional demands on the country's resources; this adds to inflationary pressures unless offset by cuts in other spending. If money repaid by Thailand in bahts were lent to India for financing imports from Thailand, Thailand would, in effect, be extending aid to India.

These difficulties with the use of local currencies are becoming more generally understood. In any event, according to the U.S. proposal, assurances would be given to the recipients of IDA financing that their local currencies would not be utilized by the Association in a manner that might produce a foreign exchange drain or disturb internal policies designed to restrain credit and mitigate inflation.

Latent in the Washington discussions of IDA was a fear that the basis of sound international lending might be undermined. The unanimous endorsement of IDA was a tribute to the confidence of world financiers in the ability of the World Bank management to steer away from the obvious rocks of disaster.

By and large, the concept of IDA appears to have two main advantages. As the World Bank's President, Mr. Eugene Black, sees it, there is need for "a more flexible type of development lending" — along with, and in addition to, the Bank's regular operations — that would provide aid without becoming a burden of a fixed charge on the borrower's foreign exchange income. Some nations, for reasons not directly attributable to poor financial management, are approaching the limits of their capacity to assume additional foreign exchange obligations which, like World Bank loans, must be serviced on a fixed timetable and in scarce foreign exchange.

Moreover, IDA would bring Western Europe and Japan into programs for helping backward areas that were hitherto financed mainly by the United States. It is worth noting that the principle of sharing the foreign aid burden is now being increasingly accepted by industrial nations as one of the main guidelines in helping develop the poorer parts of the world — the biggest challenge of the 'Sixties.



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